THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2021

MODULE 1

PRINCIPLES OF INTERNATIONAL TAXATION

TIME ALLOWED – 3¼ HOURS

This exam paper has **two** parts: **Part A** and **Part B**.

You need to answer **four** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **At least two** questions in **Part A** (25 marks each)
- **At least one** question from **Part B** (25 marks each)

Further instructions

- All workings should be made to the nearest month and you must use the appropriate monetary currency, unless otherwise stated.
- As you are using the online method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately a quarter of your time answering each of your four selected questions.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

PART A

You are required to answer AT LEAST TWO questions from this Part.

1. The word ‘enterprise’ is a frequently used technical term in the OECD Model Tax Convention (MTC) that is not defined in either the OECD MTC or the UN Model Double Taxation Convention.

   You are required to:

   1) Explore the extent to which reliance on domestic law meanings of the term ‘enterprise’ is appropriate, in the context of double taxation agreements; and (20)

   2) Consider any relevant changes made to the OECD MTC in 2000. (5)

   Total (25)

2. “There are a variety of ways to deal with debt and equity characterisation, in the context of international taxation.”

   You are required to evaluate this statement, in the context of the OECD’s work on interest deductibility and Article 9 of the OECD Model Tax Convention 2017. (25)

3. “The OECD’s work in relation to the digital economy can no longer be described as being consistent with the alignment of value creation and profitability.”

   You are required to discuss this statement, in the context of the OECD’s work in relation to the digital economy. (25)

4. **You are required to prepare a report that considers whether the introduction of a United Nations Taxation Convention, as has recently been tabled, would be more successful in resolving issues relating to the international tax framework than the OECD’s recent efforts on base erosion and profit shifting.** (25)

5. “Bilateral double taxation agreements and the provisions they contain can be justifiably treated as forming part of customary international law.”

   You are required to critically analyse this statement. (25)

PART B

You are required to answer AT LEAST ONE question from this Part.

6. ABC Ltd (a company incorporated in Country A) and XYZ Ltd (incorporated in Country X) were awarded a 'fully integrated' contract by a state-owned enterprise of Country X's government (MNO Ltd) in year 1. ABC Ltd and XYZ Ltd formed a consortium for this purpose. The contract was to fulfil certain jobs as part of a fully integrated project, and insurance was required to be taken out by ABC Ltd for the project.

   The project involved developing certain pre-existing platforms and installing them in Country X's enterprise zone (EZ), an offshore development zone off the coast of Country X. More specifically, the work required to complete the installation involved surveys, design, engineering, procurement and fabrication, as well as installation and some modification of Country X's existing facilities in the EZ. Following completion of the installation in Country X, MNO Ltd would then take over the project.

   Over the following months, ABC Ltd held various board meetings and resolved to appoint an individual to represent ABC Ltd in Country X, open an office in Country X, and act as a point of contact between MNO Ltd and ABC Ltd. The individual's tasks included signing documentation relating to the project as well as overseeing the operations of the office. The office also employed two staff who had minimal technical expertise but were required to 'co-ordinate and execute' delivery documents connected to the construction and modification of the platforms in the EZ. Later in year 1, ABC Ltd began work on various aspects of the project, most relevantly fabrication and procurement of the platforms. This took place outside of Country X and, once complete, ABC Ltd arranged for the various platforms to be installed in the EZ in year 2.

   ABC Ltd submitted a tax return to the revenue authority of Country X, recording no profit but with losses attributable to its activities in Country X. The Country X revenue authority disputed ABC Ltd's tax return and claimed that, due to the 'fully integrated' nature of the project, all work had been carried out through a permanent establishment (PE) in Country X. According to the revenue authority, ABC Ltd's tax return should have included all related profits, including profits from the successful commission of the project as these arose only in Country X. Furthermore, the revenue authority determined to attribute 20% of ABC Ltd's gross revenue as profits attributed to its PE in Country X. This amount necessarily included profits derived from activity outside Country X. The revenue authority determined that 20% of gross revenue was a reasonable attribution as it was comparable to profit margins for similar projects that they had discovered in researching various databases.

   Country A and Country X have a double taxation agreement based on the OECD Model Tax Convention 2017.

   You are required to:

   1) **Consider any potential arguments that ABC Ltd could make to deny the existence of a PE in Country X, thus limiting its liability to tax in Country X;** (10)

   2) **Consider any potential counterarguments that the revenue authority of Country X might make; and** (10)

   3) **Consider whether the arguments which you have presented are stronger for ABC Ltd or for the revenue authority of Country X, including your reasoning.** (5)

   Total (25)

7. The government of Xanadu has determined that it urgently needs to raise revenue in order to meet escalating costs associated with the recent pandemic. Estimates are that a contribution rate of 5% will need to be applied to all profits generated by business entities which derive business profits of $5 million or more per annum. The central revenue authority will collect the contribution on an annual basis. While this is expected to be a temporary contribution, no end date has been determined. The contribution will be targeted, in that it will be earmarked to cover increases in healthcare and unemployment costs resulting from the pandemic.

Xanadu has a pre-existing business entity tax (BET) that subjects all business entities to a flat tax rate of 30% on all business profits, wherever they arise. It is anticipated that the imposition of the new contribution will be on business profits that are calculated in an identical manner to the existing BET. The new contribution will also be subject to late payment interest and penalties, which also apply to Xanadu's existing taxes. Given the urgency of the fiscal situation, it has been deemed necessary to introduce the contribution as soon as possible.

A number of large businesses, whose profits are likely to be subject to the contribution, are concerned not only at the possibility of having to pay what they perceive to be an additional tax on their profits but also at the speed with which the legislation is proceeding though Xanadu's parliament. A real concern is that the details and consequences of introducing the new contribution are relatively unexplored. A group of businesses has employed a legal team to consider the validity of the rapid introduction of the contribution. While there are numerous issues for the legal team to consider, their current focus is on whether or not the new contribution is covered by Xanadu's double taxation agreement (DTA) network. They also seek to establish the possible consequences of their findings.

Broadly, Xanadu models all of its DTAs on the OECD Model Tax Convention 2017. All of Xanadu's DTAs include an identical version of Article 2, albeit with some jurisdiction-specific modifications in Article 2(3) such as references to Xanadu's personal income tax and its BET. All of Xanadu's DTAs were entered into before 2020 and the new contribution is due to be introduced in 2022.

You are required to prepare a report for the legal team that considers whether the proposed contribution is likely to be covered by Xanadu's DTA network, and whether double taxation relief will be available on payments of the new contribution by those business entities to which it applies. Your report should include the reasoning on which your conclusions are based. (25)